INFORMATION BULLETIN

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July 6, 2011

Harmonization with Certain Measures of the June 6, 2011 Federal Budget and Other Fiscal Measures

This information bulletin sets out the position of the Ministère des Finances concerning the tax measures contained in the federal budget of June 6, 2011.

It also states the position of the Ministère des Finances in respect of various announcements made by the Department of Finance Canada on the tax system, including those concerning the deductibility of contingent amounts and the tax treatment of real estate investment trusts.

In addition, this bulletin provides a thorough description of the application details of a broadening of the zero-rating measure for printed books that, for a single consideration, are supplied with a read-only medium or a right to access a website.

Lastly, it details changes to certain existing tax measures.

For information concerning the matters dealt with in this information bulletin, contact the Secteur du droit fiscal et de la fiscalité at 418 691-2236.

The French and English versions of this bulletin are available on the ministère des Finances website at: www.finances.gouv.qc.ca

Finances Québec

Harmonization with Certain Measures of the June 6, 2011 Federal Budget and Other Fiscal Measures

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1. HARMONIZATION WITH FEDERAL LEGISLATION AND REGULATIONS

1.1 Measures relating to the June 6, 2011 federal budget speech

On June 6, 2011, the Minister of Finance of Canada presented the federal government's budget for 2011. He tabled in the House of Commons Supplementary Information as well as a Notice of Ways and Means Motion to Amend the Income Tax Act and the Income Tax Regulations.[1]

In this regard, Québec's tax legislation and regulations will be amended to incorporate some of the measures announced. However, the changes to Québec's tax system will only be adopted following the assent given to any federal legislation or adoption of any federal regulation giving effect to the measures retained, taking into account the technical changes that may be made to them before such assent or adoption. Lastly, these changes will apply on the same dates as those retained for the purposes of the federal measures with which they harmonize.

❑ Measures retained

Québec's tax legislation and regulations will be amended to incorporate, with adaptations on the basis of their general principles, the measures relating to:

1. the introduction of a volunteer firefighters tax credit (BR 2),[2] it being understood that the tax credit conversion rate will be equal to the rate applicable to the first taxable income bracket of the personal income tax table;[3]

2. the eligibility of certain examination fees for the tuition tax credit (BR 8), it being understood that the examination fees stipulated in paragraph c of section 752.0.18.10 of the Taxation Act[4] will remain eligible for the tax credit for tuition and examination fees;

3. the minimum duration of courses taken at a foreign university for the purposes of the tuition tax credit (BR 9);

4. the reduction in the required duration of studies outside Canada for the purposes of educational assistance payments (BR 11);

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1 DEPARTMENT OF FINANCE CANADA, *The Next Phase of Canada's Economic Action Plan — A Low-Tax Plan for Jobs and Growth*, June 6, 2011, Annex 3, Tax Measures: Supplementary Information, Notices of Ways and Means Motions and Draft Amendments to the Income Tax Regulations, p. 255.

2 The references in parentheses correspond to the number of the budget resolution of the Notice of Ways and Means Motion to Amend the Income Tax Act and the Income Tax Regulations tabled in the House of Commons on June 6, 2011.

3 This rate is currently 16%.

4 R.S.Q., c. I-3.

5. the amendments that will be made to the Canada Education Savings Regulations[5] with respect to transfers between registered education savings plans created for the benefit of brothers or sisters;[6]

6. the easing of the rules applicable to disability assistance payments from a registered disability savings plan (BR 13 to BR 15);

7. the inclusion of capital gains for the purposes of calculating tax on split income (BR 23);

8. the restructuring of qualified donee categories for the purposes of the deduction and the tax credit for donations (BR 29*a*)), taking into account the specific features described below;

9. the registration conditions of Canadian amateur athletic associations (BR 29*b*)), whose application will be extended to Québec amateur athletic associations;

10. the application to registered Canadian amateur athletic associations of the penalty regime applicable to registered charities (BR 29*c*)(i) to (iii) in part), taking the specific features described below into account;

11. the maintenance of records and books of account by certain qualified donees (BR 29*d*)), but only where this measure concerns a Québec municipality;

12. the implementation of a penalty regime regarding certain qualified donees (BR 29e)), taking the specific features described below into account;

13. the protection of charitable assets through good governance (BR 30), whose application will be extended to Québec amateur athletic associations, museum institutions, cultural or communications organizations and political education organizations;

14. the recovery of tax assistance for returned gifts (BR 31);

15. the amendments to the rules applicable to gifts of non-qualifying securities (BR 32);

16. the tax treatment applicable to options granted to qualified donees (BR 33);

17. the exemption of capital gains regarding donations of publicly listed flow-through shares (BR 34);[7]

18. the amendments concerning the rules for qualifying environmental trusts (BR 35 to BR 37);

19. the changes to the deduction rates for intangible costs in the oil sands sector (BR 39);

20. the stop-loss rules on the redemption of shares held by corporations (BR 40);

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5 SOR/2005-151.

6 DEPARTMENT OF FINANCE CANADA, *The Next Phase of Canada's Economic Action Plan*, p. 272.

7 For greater clarity, the incorporation of this measure will not result in restricting the application of the deduction stipulated in section 726.20.2 of the Taxation Act on account of the additional capital gains exemption in respect of certain resource properties.

21. the rules concerning the limitation of deferral of corporate tax through partnerships (BR 41);

22. the extension for two years of the accelerated capital cost allowance for manufacturing and processing machinery and equipment;[8]

23. the changes concerning the accelerated capital cost allowance regarding clean energy generation applicable to equipment that generates electricity using waste heat.[9]

In addition, although it requires no legislative or regulatory amendments, the measure relating to individual pension plans (BR 22) will be retained.[10]

Moreover, the Québec government approves the federal government's initiative to apply to registered retirement savings plans and registered retirement income funds, anti-avoidance rules similar to those that apply to tax-free savings accounts (BR 16 to BR 21). However, given that there is no reason, for the moment, for Québec taxpayers making use of a retirement savings mechanism for inappropriate purposes to be penalized more heavily than any other Canadian taxpayer acting similarly, the proposed amendments, except those to be made to Part I of the Income Tax Act,[11] will be not incorporated into Québec's tax legislation and regulations.

❑ Clarifications in respect of some of the measures retained

The measure relating to the restructuring of qualified donee categories (BR 29*a*)), where it relates to a municipality in Canada, a university located outside Canada, a municipal or public body performing a function of government in Canada, a housing corporation residing in Canada or a charitable organization outside Canada, will be incorporated into Québec's tax legislation so that an entity belonging to one or other of these categories is considered a qualified donee for the purposes of the deduction and the tax credit for donations only if its name appears on a list maintained by the Minister of Revenue of Canada and the latter has not revoked its qualified donee status.[12]

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8 DEPARTMENT OF FINANCE CANADA, *The Next Phase of Canada's Economic Action Plan*, p. 304.

9 *Ibid.*

10 As part of the April 26, 1990 Budget Speech, it was announced that Québec's tax legislation and regulations would be amended so that the rules introduced by the reform of tax assistance for retirement savings would be the same as those applicable under federal income tax. However, given the degree of complexity of the provisions relating to this reform, both for individuals, employers and the tax administration, it was then decided that the integration of the federal rules would be by reference.

11 R.S.C., 1985, c. 1, 5th Supp.

12 For greater clarity, charitable organizations outside Canada to which the State has made a donation, the Organisation internationale de la Francophonie or one of its subsidiary bodies, Québec amateur athletic associations, museum institutions, cultural or communication organizations and political education organizations will remain qualified donee categories for the purposes of Québec's tax system.

Moreover, the measures relating to the application of a penalty regime to registered Canadian amateur athletic associations and to certain qualified donees will, except for those relating to the imposition of penalties, be retained for the purposes of Québec's tax system (BR 29c)(i) to (iii) and BR 29e)) and adapted to:

- enable the Minister of Revenue to suspend the power of a Québec municipality or registered amateur athletic association to issue receipts for donations and gifts, bearing the mention that they are Québec income tax receipts, when it has breached the requirements regarding records, and to extend the scope of this measure against a registered Québec amateur athletic association;
- stipulate that, where the power of a registered Canadian amateur athletic association, a municipality of Canada, a university located outside Canada, a charitable organization outside Canada, a municipal or public body performing a function of government in Canada or a housing corporation residing in Canada to issue official tax receipts is, for a given period, suspended for the purposes of federal tax legislation and regulations, the power of such entity to issue receipts for donations and gifts, bearing the mention that they are Québec income tax receipts will be deemed, for the same period, suspended for the purposes of Québec's tax legislation and regulations, it being understood that any deferral granted by the Tax Court of Canada in relation to the suspension period must be taken into account;
- grant to the Minister of Revenue the power to revoke the registration of a registered Canadian amateur athletic association that grants an unjustified benefit to a person or carries on a business that is not related to its purpose and function, and extend the scope of this power of revocation regarding a registered Québec amateur athletic association.

❑ Measures not retained

Some measures have not been retained because they do not correspond to the features of Québec's tax system or because Québec's tax system has no corresponding provisions. Such is the case for the measures concerning:

- the introduction of a children's arts tax credit (BR 1);
- the elimination of the $10 000 cap on eligible expenses for the purposes of calculating the medical expense tax credit for a dependant (BR 6);
- the eligibility conditions for the child tax credit (BR 7);
- the minimum duration of courses taken at a foreign university for the purposes of the education tax credit and the textbook tax credit (BR 10);
- transfers between plans for the purposes of the tax in respect of overpayments to registered education savings plans (BR 12);
- the mineral exploration tax credit (BR 25);

— the payment of the goods and services tax credit (BR 27);

— the disclosure of information on registered Canadian amateur athletic associations (BR 29c)(v)).

Other measures have not been retained because Québec's tax system is satisfactory in their regard. This applies to the measures on:

— the addition of an amount for family caregivers for the purposes of calculating certain personal tax credits (BR 3 to BR 5);

— the tax treatment applicable to investments made under the Agri-Québec program (BR 24);

— the marital status changes for the purposes of the Canada child tax benefit (BR 26);

— the payment of the Canada child tax benefit (BR 28);

— the imposition of a penalty on a registered Canadian amateur athletic association that fails to file a return (BR 29c)(iv));

— the rate used in the calculation of the tax payable by a qualifying environmental trust (BR 38).

1.2 News release 2011-024 of March 16, 2011

On March 16, 2011, the Department of Finance of Canada made public by way of a news release legislative proposals amending the Income Tax Act[13] and Income Tax Regulations[14] concerning the deductibility by a taxpayer of contingent amounts, the tax treatment of a life insurance corporation's reserves in respect of its segregated fund policies and the withholding tax that applies to interest payments made to non-residents.

Briefly, these legislative proposals specify, in respect to the deductibility by a taxpayer of contingent amounts, that the amount of a taxpayer's unpaid expense, otherwise deductible for income tax purposes, does not include an amount that the taxpayer, or a person with whom it is not at arm's length, has the right to reduce or eliminate. They also specify the application of the rules for computing a life insurance corporation's segregated fund policy reserves.

Since, as a general rule, Québec's tax system is harmonized with the federal tax system insofar as the deductibility of an unpaid expense is concerned and with the rules on the calculation of segregated fund policy reserves of life insurers, Québec's tax legislation and regulations will be amended to incorporate, with adaptations on the basis of their general principles, these legislative proposals.

13 R.S.C., 1985, c. 1, 5th Supp.

14 C.R.C., c. 945.

Moreover, the changes that will be made to Québec's tax system will be adopted only after the assent of any federal statute or the adoption of any federal regulations implementing the retained measures, taking into account technical amendments that may be made prior to such assent or adoption. These amendments will apply on the same dates as those for the purposes of the federal amendments to which they are harmonized.

Concerning the proposal relating to the tax withholding that applies to interest payments made to non-residents, it will not be retained since Québec's tax system does not contain corresponding provisions.

1.3 News release 2011-009 of January 28, 2011

On January 28, 2011, the Department of Finance of Canada issued a news release containing proposed changes to certain rules of the goods and services tax and the harmonized sales tax relating to financial institutions.

Given that, generally speaking, these proposed changes to the federal tax system do not correspond to the characteristics of the Québec sales tax (QST) system, they will not be incorporated into the latter, with the exception of those authorizing financial institutions that have elected a monthly or quarterly reporting period to revoke such election and thus file their returns on an annual basis.

The changes incorporated into the QST system will be adopted only after the approval of any law or adoption of any regulation arising from the federal news release, taking into account technical amendments that might be made prior to such approval or adoption. They will apply on the same dates as those for the purposes of the federal changes to which they are harmonized.

1.4 News release 2010-125 of December 16, 2010

On December 16, 2010, the Minister of Finance of Canada issued a news release making public proposed amendments to income tax legislation concerning the tax treatment of real estate investment trusts (REITs).

Generally speaking, a REIT is a trust that is exempt from the tax on specified investment flow-through entities. To qualify as a REIT, a trust must satisfy certain conditions. The proposed amendments are related to the REIT qualification rules. Essentially, these amendments give REITs more flexibility as to the source of some of their revenue as well as to the holding of some of their property.

Given that Québec's tax system is harmonized with the federal tax system as far as the tax treatment of REITs is concerned, Québec's tax legislation will be amended to incorporate, with adaptations based on its general principles, the proposed amendments relating to REITs.

The amendments to Québec's tax system will be adopted only after assent has been given to any federal statute implementing these proposals, taking into account technical amendments that may be made prior to such assent. In addition, these amendments will apply on the same dates[15] as those for the purposes of the federal proposals with which they harmonize.

2. OTHER FISCAL MEASURES

2.1 Broadening of the zero-rating measure for printed books

Currently, the Québec sales tax (QST) system stipulates the zero-rating of the supply of a printed book identified by an International Standard Book Number (ISBN). This measure specific to Québec's tax system carries over the exemption stipulated in this regard in the former retail sales tax system that the QST system replaced in 1992.

However, with the development of information transmission methods over the last decade, it has become increasingly common for printed books to be supplied with a data storage medium (a CD-ROM for example) or a right to access a website for a single price, particularly in the education sector. In general, the effect of such marketing is to give rise to the supply of a new product that consequently is taxable, despite the fact that the printed book may be the main component.

Given that the application of the QST is not desirable in these particular circumstances because of the impact such application could have both in the education sector and the literature sector in general, the zero-rating measure for printed books will therefore be broadened to cover this situation.

More specifically, the zero-rating measure will be changed to also apply where, for a single consideration, a printed book is supplied with a read-only medium or a right to access a website (hereinafter referred to as "other property"), provided the following conditions are satisfied:

— the book and the other property are wrapped, packaged, combined, or otherwise prepared to be supplied as an inseparable whole of which they are the only elements;

— It is reasonable to consider that the book is the main component of the supply.

For the purposes of this broadening, the expression "read-only medium" means a tangible medium designed for storage, in read-only mode, of information and other data in digital form.

This change will apply to the supply of a printed book accompanied by other property made after October 31, 2011.

15 The proposals will be effective for the 2011 and subsequent taxation years and also on an elective basis for earlier taxation years (i.e. the 2007, 2008, 2009 and 2010 taxation years).

2.2 New non-reducing amount of assistance for the purposes of the refundable tax credit for book publishing

In general, the amount of any government assistance and any non-government assistance that a corporation received or is entitled to receive must reduce the amount of the eligible labour expenditure attributable to printing and reprinting costs and the amount of the eligible labour expenditure attributable to preparation costs of the corporation that are included in the calculation of the refundable tax credit for book publishing.

However, for the purposes of this tax credit, government assistance or non-government assistance does not include an amount paid under the Book Publishing Industry Development Program (BPIDP). This program ceased activities March 31, 2010 and was replaced by the Canada Book Fund.

Consequently, so that the amount of financial assistance granted by the Canada Book Fund not reduce the amount of one or the other eligible labour expenditures calculated for the purposes of the tax credit for book publishing, the tax legislation will be amended so that government assistance or non-government assistance does not include the amount of such financial assistance.

This amendment will apply as of April 1, 2010.

2.3 Recognition of new centres as a college technology transfer centre and as an eligible public research centre

A corporation that carries on a business in Québec and has an establishment there can obtain a refundable tax credit for technology adaptation services of 50% in relation to eligible liaison and transfer services carried out on its behalf by a college technology transfer centre (hereunder "CTTC") in the course of a contract that the corporation entered into with such centre.

A taxpayer who carries on a business in Canada can obtain a refundable tax credit for scientific research and experimental development (R&D) of 35% in relation to R&D activities carried out on his behalf, in Québec, by an eligible public research centre in the course of an eligible research contract that the taxpayer enters into with such a centre.

In this regard, it is the responsibility of the Ministère des Finances to recognize a research centre as a CTTC and as an eligible public research centre for the purposes of these two refundable tax credits.

On the one hand, to recognize a centre as a CTTC for the purposes of the refundable tax credit for technology adaptation services, the Ministère des Finances checks with the Ministère de l'Éducation, du Loisir et du Sport whether it has recognized the centre as a CTTC.

On the other, to recognize a centre as an eligible public research centre for the purposes of the refundable tax credit for R&D, the Ministère des Finances requires that the centre demonstrate its capacity, in terms of human, physical and financial resources, to carry out R&D work on behalf of businesses. Accordingly, the employees of the centre must have the qualifications required to carry out R&D work awarded on a sub contracting basis to the research centre, and the research centre must have premises and equipment that enable it to do the work in its field of expertise.

In addition, the research centre must obtain most of its financing from public funds.

Two new centres will be recognized for the purposes of the refundable tax credit for technology adaptation services and the refundable tax credit for R&D.

Accordingly, the Centre des technologies de l'eau and the Cégep de Trois-Rivières, regarding its Centre collégial de transfert de technologie en télécommunications (C2T3), will be recognized as CTTCs for the purposes of the refundable tax credit for technology adaptation services, and will also be recognized as eligible public research centres for the purposes of the refundable tax credit for R&D.

Recognition of the Centre des technologies de l'eau will apply regarding eligible liaison and transfer services and regarding R&D carried out by the centre after December 31, 2009 under a contract entered into after that date.

Recognition of the Cégep de Trois-Rivières, regarding its Centre collégial de transfert de technologie en télécommunications (C2T3), will apply regarding eligible liaison and transfer services and regarding R&D carried out by the centre after December 31, 2008 under a contract entered into after that date.

2.4 Measures pertaining to tax-advantaged funds

Since the creation of the Fonds de solidarité FTQ, Fondaction[16] and Capital régional et coopératif Desjardins, the government has supported the growth of these investment corporations by allowing them to collect capital enjoying a tax benefit consisting of a non-refundable tax credit to individuals who become shareholders of them.

Since these investment funds' financing is made easier by granting a tax benefit, investment requirements were included in their statutes of incorporation[17] to ensure, in particular, that the funds collected are used as a financing tool contributing to the development of Québec entities.

16 The Fonds de développement de la Confédération des syndicats nationaux pour la coopération et l'emploi.

17 I.e. the Act to establish the Fonds de solidarité des travailleurs du Québec (F.T.Q.) (R.S.Q., c. F-3.2.1), the Act to establish Fondaction, le Fonds de développement de la Confédération des syndicats nationaux pour la coopération et l'emploi (R.S.Q., c. F-3.1.2) and the Act constituting Capital régional et coopératif Desjardins (R.S.Q., c. C-6.1).

Each of the statutes of incorporation of these investment corporations stipulates that, during each fiscal year, the corporation's eligible investments must represent, on average, at least 60% of the corporation's average net assets for the preceding fiscal year.[18]

Should these corporations fail to satisfy this investment requirement, hereafter called "60% standard", a sanction is imposed on them.

Accordingly, so that the 60% standard does not limit the participation of the Fonds de solidarité FTQ in structuring projects for Québec's economy, an amendment will be made to its statute of incorporation.

In addition, a clarification will be made to statutes of incorporation of the three tax-advantaged funds to confirm the extent of the application of the rules established for the purposes of calculating the assets or net equity of a business in which investments can be made.

Lastly, the annual issuance limit temporarily imposed on Fondaction will be changed to take into account the fact that a large proportion of its shares are subscribed for through payroll deductions.

❑ Increased recognition of the major investments made by the Fonds de solidarité FTQ

Currently, investments eligible for the 60% standard imposed to the Fonds de solidarité FTQ include investments[19] of strategic value to Québec's economy made by the Fund in an entity – partnership or legal person – and consisting of an initial investment of at least $25 million or an additional investment, provided, on the one hand, that the Minister of Finance, after December 22, 2004, has recognized the strategic value of the initial investment and, if applicable, of the additional investment and, on the other hand, that these investments are not otherwise eligible investments.

However, where, at a given time during a fiscal year, the Fonds de solidarité FTQ holds, in a number of entities, investments that could be included in this category, hereinafter called "major investment category", it is stipulated that only the investments held in one of them can be considered eligible, at such time, for the purposes of the 60% standard, up to a maximum of 5% of its net assets at the end of the previous fiscal year.

To better adapt the major investment category to the extent of the sphere of activities in which the Fonds de solidarité FTQ operates, the restriction limiting this category to the investments held in one and the same entity will be removed.

This change will apply to any fiscal year of the Fonds de solidarité FTQ beginning after May 31, 2010.

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18 This investment requirement also contains, in the case of Capital régional et coopératif Desjardins, a regional component.

19 For greater clarity, such investments must include no security bond or hypothec.

❑ Clarification concerning the determination of the assets or net equity of a business for the purposes of calculating the 60% standard of tax-advantaged funds

As a general rule, the size of the businesses in which investments are made is a crucial criterion for the purposes of the 60% standard. To this end, the size of a business is measured on the basis of its assets or net equity.

Currently, the statutes of incorporation of tax-advantaged funds stipulate, only for certain types of investments, that the assets or net equity of a business are the assets or net equity shown in its financial statements for its fiscal year ended before the date when the investment is made, minus the write-up surplus of its property and the incorporeal assets. In the case of a business that has not completed its first fiscal year, a chartered accountant must confirm in writing to the tax-advantaged fund that the assets or net equity of the business, as the case may be, are less immediately before the investment than the stipulated limits.

While, at the legislative level, these clarifications are not aimed at all types of investment whose eligibility is dependent on the size of a business, in fact, they have always been considered as having general application.

In this context, the statutes of incorporation of tax-advantaged funds[20] will be amended, with declaratory effect, to extend the application of the clarifications pertaining to the determination of the assets or net equity of a business to all types of investment with reference to the size of a business.

❑ Change to the annual issuance limit temporarily imposed on Fondaction

To enable Fondaction to achieve an optimal level of capitalization so that it can pursue its mission, it was announced, in the 2009-2010 Budget Speech, that the rate of the tax credit for the acquisition of a class "A" or class "B" share or fraction of a share issued by Fondaction, hereinafter referred to as "eligible share", will be temporarily increased to 25% for any eligible share acquired after May 31, 2009 and no later than the date on which ends the fiscal year at the end of which Fondaction first reaches a level of capitalization of at least $1.25 billion.

For an eligible share acquired as of the date of the beginning of the first fiscal year of Fondaction following that at the end of which it first reaches a level of capitalization of at least $1.25 billion, the rate of the tax credit applicable to the issue price paid for such a share will be reduced from 25% to 15%.

20 See note 17.

Moreover, to control the tax expenditure attributable to this new government support, a limit was imposed on the capital Fondaction may collect. Accordingly, for a given fiscal year of Fondaction beginning after May 31, 2009, the aggregate of amounts each of which is an amount paid during a given fiscal year for the purchase as a first acquirer of an eligible share,[21] hereinafter called "amount of capital collected", is limited to $150 million, so long as Fondaction has not reached for the first time at the end of a fiscal year, at least $1.25 billion on account of paid-up capital regarding eligible shares issued and outstanding.

In the event where, at the end of a given fiscal year, the amount of capital collected for such year exceeds $150 million, Fondaction shall pay to the Minister of Revenue, no later than the 90th day following the end of such fiscal year, a tax equal to 25% of such excess amount.

To take into account the fact that the growing popularity of payroll deductions and pre-authorized withdrawals as a method of subscribing for the shares of Fondaction may make the administrative follow-up required by a fixed annual issuance limit more difficult, changes will be made to better adapt the applicable limit to this situation.

More specifically, for a given fiscal year of Fondaction beginning after May 31, 2010 and ending no later than May 31 of the fiscal year during which the paid-up capital regarding the eligible shares of its capital stock reaches, for the first time, $1.25 billion, the amount of capital that can be collected for a given fiscal year, hereinafter referred to as "maximum authorized amount for the year", will be equal to the total of $150 million and the excess of the maximum authorized amount for the fiscal year preceding the given year[22] over the amount of capital collected for the fiscal year preceding the given year.

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21 For greater clarity, an amount paid for the purchase of a share or fraction of a share includes only the issue price paid for such share or fraction of a share.

22 For greater clarity, where the fiscal year preceding a given year is the financial year ending May 31, 2010, the maximum authorized amount for such year will be equal to $150 million.